

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 6: Research and development allowances

Overview

1488. This Part provides for research and development (R&D) allowances. Unlike other Parts the allowances are not labelled as initial, first-year, writing-down or balancing allowances. Allowances are broadly given at a rate of 100%. Balancing charges can recover “excessive allowances”.
1489. The aim is to give traders relief against trading income for capital expenditure on R&D. The R&D must be related to the trade and directly undertaken by the trader or on his or her behalf.
1490. [Chapter 1](#) is introductory. It requires a person to have incurred qualifying expenditure on R&D to get allowances. The Chapter gives the meaning of “research and development” and what may be treated as expenditure on R&D.
1491. [Chapter 2](#) gives the meaning of “qualifying expenditure”. Only traders can have qualifying expenditure and such expenditure must be incurred on R&D which is directly undertaken by the trader or on behalf of the trader. The cost attributable to bare land or most dwellings is not qualifying expenditure.
1492. [Chapter 3](#) deals with allowances and charges on qualifying expenditure. There is no pooling of qualifying expenditure. The rate of allowances is 100%. Allowances are broadly given for the chargeable period in which occurs the later of:
- the trade starting; or
 - the qualifying expenditure being incurred.
1493. When the trader ceases to own an asset representing qualifying expenditure a disposal value is brought into account (usually for the chargeable period in which it ceases to be owned). Disposal values either restrict allowances on the qualifying expenditure or lead to a balancing charge. Demolition costs may reduce disposal values or qualify for an allowance.
1494. [Chapter 4](#) treats certain additional VAT liabilities as expenditure on R&D and certain additional VAT rebates as disposal values. The consequences of such treatment follow from the earlier Chapters. The additional VAT must be incurred or made by the time the asset in question is destroyed or ceases to be owned.
1495. [Chapter 5](#) contains supplementary provisions including the treatment of allowances as trading expenses and charges as trading receipts.

History

1496. This Part has its origins in sections 28, 29 and 31 of FA 1944 (when the allowances were known as “scientific research allowances”). Minor changes were made to those sections in Income Tax Act 1945 (the Act which introduced capital allowances generally for expenditure on, among other things, industrial buildings and machinery or plant).
1497. Allowances were originally given for R&D expenditure (then called “scientific research expenditure”) of a capital nature over five years at 20% a year.
1498. If the expenditure was represented by an asset, there could be no claim for other types of capital allowance while the asset continued in use for R&D related to the trade concerned. But, if that asset ceased to be so used, there was then a balancing adjustment. The adjustment ensured the net relief equalled any loss in value of the asset by the date of its change of use. After that adjustment the person could claim other types of capital allowance.
1499. Section 20 of FA 1949 changed the rate of R&D allowances to 60% in the first year and 10% in each of the next four years.
1500. Section 21 of FA 1954 introduced provisions giving accelerated relief for the cost of demolishing assets representing capital expenditure on R&D.
1501. Section 36 of FA 1963:
- increased R&D allowances to 100%;
 - amended the provisions dealing with “balancing allowances” and “balancing charges” to fit the new regime of 100% allowances; and
 - provided that if an asset was bought and sold in the same year, an allowance was given in that year on any net cost of the asset. As a result any allowance otherwise due in the next year (on the preceding year basis of assessment then in force) was not to be given.
1502. Section 63 of FA 1985 stopped R&D allowances being given:
- on the cost of acquiring land or rights in or over land (except to the extent that part of the cost is properly attributable to a current building or structure on that land); and
 - for expenditure on the provision of residential accommodation (except if the accommodation forms part of the premises used for R&D and the cost of that accommodation is not more than 25% of the cost of the entire structure).
1503. FA 1985 also expanded the recapture of allowances on an asset ceasing to be owned – previously a sale of the asset was required.
1504. Section 62 of FA 1988 introduced new capital gains tax and capital allowance rules for arm’s length disposals, made at the “pre-development” stage, of interests in oil licences in the UK or on the UK Continental Shelf. The new rules applied if the consideration for the disposal included either:
- an obligation to undertake a program of exploration and appraisal work in the area covered by the licence; or
 - another such “pre-development” licence interest.
1505. Such consideration is treated as having a nil value for the purpose of recovering R&D allowances on the disposal of the licence interest.
1506. [Section 121](#) and Schedule 13 of FA 1989 introduced provisions that:
- allow apportionment of expenditure if an asset is sometimes to be used for R&D and sometimes to be used for other purposes;

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- define when an asset, that is sold, ceases to be owned; and
 - give a single set of provisions to prevent double allowances whereby claimants make an irrevocable choice as to what type of allowance they wanted on particular expenditure.
1507. CAA 1990 consolidated the provisions about capital allowances (other than those contained in Chapter I of Part XIII of ICTA).
1508. FA 1991 introduced changes so that:
- additional VAT liabilities on an amount that got a R&D allowance might also qualify for such an allowance; and
 - additional VAT rebates would give rise to a recapture of allowances.
1509. FA 1996 inserted section 138A of CAA 1990. This was to make sure that R&D allowances on capital expenditure on mineral exploration and access could be recovered on the disposal of an interest in an oil licence, to the extent that the expenditure had added value to the oil licence. This provision applied retrospectively as well as prospectively. FA 1996 therefore inserted section 138B of CAA 1990 to cater for the potentially retrospective element of section 138A. Section 138B allowed the transferor to use a lower disposal value than that given by section 138A, if that value was also used in calculating the transferee's entitlement to capital allowances.
1510. FA 1996 also:
- applied section 151 of CAA 1990, dealing with apportionments that could affect more than one person, to Part VII of CAA 1990; and
 - extended the relief mentioned in paragraph 1504 above so that it applies to oil licences world-wide and not only to UK and UK Continental Shelf licences.
1511. FA 2000 changed:
- the term "scientific research" previously used to the present term "research and development";
 - introduced a more detailed definition of what constitutes R&D; and
 - ensured that appeals on the meaning of "research and development" could go to an independent tribunal.

Chapter 1: Introduction

Overview

1512. This Chapter introduces R&D allowances. They are given to traders who incur qualifying expenditure. Chapter 2 defines "qualifying expenditure" and contains the condition that the person must be a trader.
1513. [Section 437](#) requires qualifying expenditure on R&D in order for allowances to be given and defines "research and development".
1514. [Section 438](#) gives the meaning of "expenditure on research and development". That meaning excludes, with minor exceptions, expenditure on dwellings.

Section 437: Research and development allowances

1515. This section is based on section 139(1)(a) of CAA 1990.
1516. *Subsection (1)* provides that qualifying expenditure on R&D is needed before allowances can be made.

1517. *Subsection (2)* gives the extended meaning of “research and development” in this Part to include oil and gas exploration and appraisal.

Section 438: Expenditure on research and development

1518. This section is based on sections 137(3) and 139(1)(c) of CAA 1990. It sets out what is included and excluded from being expenditure on R&D and also permits just and reasonable apportionments of expenditure.
1519. *Subsection (4)* is more explicit than section 137(3) of CAA 1990, in that it only permits certain expenditure on a dwelling to be treated as on R&D. See *Note 53* in Annex 2.
1520. *Subsection (5)* requires any apportionment to be “just and reasonable”. This is a change, see *Change 40* in Annex 1.

Chapter 2: Qualifying expenditure

Overview

1521. This Chapter defines “qualifying expenditure” and excludes expenditure on “land” from being qualifying expenditure.
1522. [Section 439](#) defines “qualifying expenditure”.
1523. [Section 440](#) prevents expenditure on land from being qualifying expenditure subject to exceptions for existing buildings or structures on the land.

Section 439: Qualifying expenditure

1524. This section is based on sections 137(1) and (4) and 139(1)(d) and (2) of CAA 1990.
1525. It sets out the conditions to be satisfied for a person to have qualifying expenditure. There are two threads depending on whether the expenditure is incurred while the person is trading or before that trade starts.
1526. Some conditions are common to the two threads. These are that:
- the person must be a trader;
 - the expenditure must be capital expenditure incurred by the person on R&D; and
 - the R&D must be directly undertaken by the person or on the person’s behalf.
1527. For expenditure incurred before the person starts trading, the trade has to be connected with the R&D.
1528. For expenditure incurred while trading, the trade must be related to the R&D.
1529. *Subsection (3)* introduces “the relevant trade” as a term that can be used to avoid the need for phrases such as “the trade in respect of which the expenditure has been treated as qualifying expenditure”.
1530. *Subsection (4)* requires any apportionment to be “just and reasonable”. This is a change, see *Change 40* in Annex 1.
1531. *Subsection (5)* extends the R&D that can be treated as related to a trade that the person is carrying on.

Section 440: Excluded expenditure: land

1532. This section is based on section 137(2) of CAA 1990. It stops the cost of land (other than the amount attributable to buildings or structures on the land) from being qualifying expenditure.

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1533. Section 137(2) of CAA 1990 takes a slightly different approach. It prevents allowances being given on such expenditure but it is not thought that there is any difference. For a more detailed discussion see *Note 54* in Annex 2.
1534. *Subsection (3)* uses the term “just and reasonable apportionment”. This is a change, see *Change 40* in Annex 1.

Chapter 3: Allowances and charges

Overview

1535. This Chapter deals with allowances and charges on qualifying expenditure. There is no pooling of qualifying expenditure. An allowance can be made in respect of qualifying expenditure only for one chargeable period. Disposal values may arise in relation to qualifying expenditure on the happening of certain events. Disposal values restrict allowances on the qualifying expenditure or result in balancing charges to recover excessive allowances. Demolition costs may reduce balancing charges or, in certain cases, give rise to allowances.
1536. [Section 441](#) sets out when an allowance can be made, the chargeable period for which it is made and its amount.
1537. [Section 442](#) sets out when a person is liable to a balancing charge and its amount.
1538. [Section 443](#) deals with disposal values and the events on which they arise. Disposal values are relevant to the previous two sections. There are signposts to a special provision relating to oil licences and also to the Chapter dealing with additional VAT rebates.
1539. [Section 444](#) deals with the chargeable period for which a disposal value is to be brought into account.
1540. [Section 445](#) sets out relief available for the costs of demolishing an asset representing qualifying expenditure.

Section 441: Allowances

1541. This section is based on sections 137(1) and (5) and 138(2) of CAA 1990.
1542. This section uses the term “allowances” instead of “deduction in taxing a trade” which is found in CAA 1990. See *Note 55* in Annex 2 for more detail.
1543. CAA 1990 essentially gives an allowance of 100% of qualifying expenditure and a charge (capped at the allowance given) of all of the disposal value relating to that qualifying expenditure. This section takes a different approach.
1544. *Subsection (1)* gives an allowance in the relevant chargeable period. The allowance equals the excess of qualifying expenditure over any disposal value taken into account for that relevant chargeable period (instead of an allowance equal to that qualifying expenditure and a charge on that disposal value). See *Change 39* in Annex 1.
1545. *Subsection (2)* defines “relevant chargeable period”, a term used in subsection (1). There are minor differences between the formulation used in subsection (2)(b) and that used in section 137(5) of CAA 1990 which looks at whether the expenditure was incurred “before the setting up and commencement of the trade” rather than before the chargeable period in which the trade is set up and commenced. See *Note 56* in Annex 2.
1546. *Subsection (3)* permits a claim of less than the full amount of an allowance to be made by the person. See *Change 38* in Annex 1.

Section 442: Balancing charges

1547. This section is based on section 138(1), (2) and (2A) of CAA 1990.
1548. *Subsections (1) to (3)* provide a balancing charge if a disposal value arises in a chargeable period after the one in which an allowance is made in respect of the qualifying expenditure concerned. There is no longer a balancing charge in the same period as an allowance is made – see *Change 39* in Annex 1. The balancing charge is limited to the allowance previously made in respect of that qualifying expenditure. Section 138(2) of CAA 1990 refers to a “trading receipt” but it seems clearer to follow the other Parts of this Act and refer to a balancing charge. It is not thought that this has any effect. See *Note 55* of Annex 2.
1549. *Subsection (4)* defines the term “unclaimed allowance”. Most people will claim all of the allowances to which they are entitled because there is no possibility of getting any amount unclaimed in a later chargeable period. But having recognised the possibility that a reduced claim may be made it is necessary to ensure that balancing charges are not made if such a person has a disposal value but the allowance claimed is not more than the net cost of the R&D asset concerned. This is achieved by subsection (3)(a) which uses this term. See *Change 49* in Annex 1.
1550. *Subsection (5)* signposts the effect that additional VAT rebates may have on the amount in subsection (4). That alerts users who may be affected but leaves this section simple for the majority who will not be affected by VAT rebates.

Section 443: Disposal values and disposal events

1551. This section is based on sections 138(1), (3A), (4), (5) and (6) and 138A(1) of CAA 1990. It says when a disposal value is brought into account and gives a Table from which the amount of the disposal value can be found.
1552. *Subsection (1)* gives the main cases in which a disposal value must be brought into account.
1553. *Subsection (2)* is a signpost to another case in which a disposal value must be brought into account.
1554. *Subsection (3)* gives cases excluded from subsection (1).
1555. *Subsection (4)* has a Table giving the disposal value if subsection (1) applies. There are minor changes referring to:
- “net proceeds” of sale; section 138(4)(a) of CAA 1990 refers to “proceeds”; and
 - limiting other compensation to “capital sums” – a limitation which is not in section 138(5) of CAA 1990
1556. These bring the Table closer to the formulations used in other Parts of this Act. See *Change 50* in Annex 1.
1557. *Subsection (5)* sets out exceptions from subsection (4).
1558. *Subsection (6)* provides a signpost to a provision concerning additional VAT rebates that could lead to a disposal value being brought into account without the existence of a disposal event.
1559. *Subsection (7)* defines “disposal event”.

Section 444: Disposal events: chargeable period for which disposal value is to be brought into account

1560. This section is based on section 138(2) of CAA 1990.

1561. *Subsection (1)* says that this section is about the chargeable period for which a disposal value under section 443 is brought into account. Section 138(2) of CAA 1990 gives a specific time at which, essentially, a balancing charge arises whereas this section provides a chargeable period for which a disposal value arises. The approach in this section is more consistent with other Parts of this Act that bring disposal values into account for a chargeable period and with R&D allowances being given for a chargeable period. See *Note 57* in Annex 2.
1562. *Subsections (2) and (3)* deal with the normal case in which the disposal event occurs after the chargeable period for which an allowance is made. They also deal with the less usual case in which the disposal event occurs in the same chargeable period as an allowance is made for the qualifying expenditure. Subsection (3)(a) contains a change. See *Change 51* in Annex 1.
1563. *Subsection (4)* deals with the unusual case in which a disposal event occurs before the chargeable period for which an allowance is due in respect of the qualifying expenditure concerned. CAA 1990 does not appear to explicitly address this situation. Section 138(3) of CAA 1990 looks as if it might be in point but it does not handle this case satisfactorily. Subsection (4) deals with the unusual case in a more coherent fashion. See *Change 51* in Annex 1.

Section 445: Costs of demolition

1564. This section is based on sections 138(5) and 139(5) of CAA 1990. Section 138(5) is particularly difficult to follow. Its reference to “the person carrying on the trade” might suggest that demolition costs are ignored if they are incurred before the trade commences. This section proceeds on the basis that such costs ought not to be ignored. See *Change 52* in Annex 1.
1565. *Subsections (1) to (3)* allow the net demolition costs of an asset representing qualifying expenditure to reduce the disposal value that arises on that demolition.
1566. *Subsections (4) and (5)* provide for an allowance if the net demolition costs are greater than the disposal value. But only if, prior to demolition, the asset has only ever been used for R&D related to the relevant trade.
1567. *Subsection (6)* stops the demolition costs being taken into account more than once.

Chapter 4: Additional VAT liabilities and rebates

Overview

1568. This Chapter deals with the effect of additional VAT liabilities and rebates in respect of an asset representing qualifying expenditure. They can result in additional qualifying expenditure or generate (or increase) a disposal value.
1569. [Section 446](#) points to the definition of the terms used in this Chapter.
1570. [Section 447](#) treats certain additional VAT liabilities as if they were capital expenditure on R&D.
1571. [Section 448](#) treats certain additional VAT rebates as if they were disposal values and deals with their effect on the calculation of allowances and charges in later chargeable periods.

Section 446: Introduction

1572. This section gives a signpost to the places where the terms used in this Chapter are defined. Those definitions apply to several Parts.

Section 447: Additional VAT liability treated as additional expenditure etc.

1573. This section is based on sections 137(1A), 138(1) and 159A(3) of CAA 1990.
1574. *Subsection (1)* treats the additional VAT liability as if it was capital expenditure on the same R&D. That is a necessary, but not sufficient, condition for the additional VAT liability to be qualifying expenditure.
1575. *Subsection (2)* excludes from subsection (1) additional VAT liabilities incurred after a certain time.
1576. *Subsection (3)* gives the chargeable period for which an allowance resulting from an additional VAT liability is to be made. The wording of subsection (3)(b) is related to section 441(2)(b). See *Note 56* in Annex 2.

Section 448: Additional VAT rebate generates disposal value

1577. This section is based on section 138(3A) of CAA 1990. It treats an additional VAT rebate, to which the section applies, as if it is a disposal value to be brought into account (usually) for the chargeable period in which the rebate accrues. The words “or, if the rebate is made on or after the date on which the trade is permanently discontinued, accruing immediately before the discontinuance” at the end of section 138(3A) are thought to be unnecessary and have not been rewritten. See *Note 58* in Annex 2.
1578. *Subsections (1) to (3)* set out the additional VAT rebates to which the section applies. The reference in section 138(3A) of CAA 1990 to a person “carrying on a trade” could be thought to indicate that VAT rebates are ignored if they are made before the relevant trade starts. Section 444 now provides that relief can be obtained for the commercial loss where an asset is bought and sold at a loss before the relevant trade starts. It would be odd if VAT rebates made in relation to such an asset, and which are a factor in arriving at the commercial loss, were ignored. This section proceeds on the basis that such rebates are taken into account just as an additional VAT liability incurred before the relevant trade starts might be taken into account under section 137(1A) and 137(5) of CAA 1990. See *Change 53* in Annex 1.
1579. *Subsections (4) and (5)* provide that the VAT rebate is treated as a disposal value. This differs from section 138(3A) of CAA 1990 that effectively provides that the whole of the VAT rebate is treated as a balancing charge. In most cases this will have no effect because the person has claimed a 100% allowance. But it could have an effect if the person claims less than the full allowance available on the qualifying expenditure. This change reduces the charge in such a case. See *Change 49* in Annex 1.

Section 449: Effect on balancing charges of additional VAT rebates in earlier chargeable periods

1580. This section is based on section 138(1), (2) and (2A) of CAA 1990.
1581. The treatment of VAT rebates as disposal values under section 448 means that, in contrast to section 138(3A) of CAA 1990, the receipt of the VAT rebate may not lead to a balancing charge because there are unclaimed allowances under section 442(4).
1582. To the extent that an unclaimed allowance shields a disposal value in one chargeable period this section reduces, for later chargeable periods, that unclaimed allowance by the amount shielded so that relief is not obtained more than once. See *Change 49* in Annex 1.

Chapter 5: Supplementary provisions

1583. This Chapter deals with giving effect to allowances and charges and the time when an asset that is sold ceases to be owned.

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Section 450: Giving effect to allowances and charges

1584. This section is based on sections 137(1), 140(2) and (5), 144(2) and (3) and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges as trading expenses or trading receipts in the chargeable period for which they are made.

Section 451: Sales: time of cessation of ownership

1585. This section is based on section 139(4) of CAA 1990. It defines references to the time of cessation of ownership in the case of a sale.